



CROATIAN NATIONAL BANK

Information on economic trends

May 2016

Summary

According to the monthly indicators of economic activity, real GDP growth continued at the beginning of 2016, following a temporary decline at the end of 2015. This is supported by data on the strong growth of industrial production, construction and retail trade as well as the continuation of favourable developments in the labour market. The annual decline in consumer prices accelerated to -1.7% in March, as a result of developments in the prices of energy, while the decline in the rate of core inflation slowed down to -0.5% . Despite a very expansionary monetary policy, the exchange rate of the kuna against the euro was 2.1% lower at the end of April than at the end of 2015. In the first quarter of 2016, the placements of banks increased moderately, which was mostly the result of the increase in lending to enterprises, while placements to households, excluding the impact of the partial write-off of loans in Swiss francs associated with the process of conversion, stagnated. Cash fiscal data show that favourable fiscal developments continued at the beginning of the current year after the strong consolidation in 2015.

The GDP nowcasting model shows that real economic activity increased in the first quarter of 2016 relative to the previous quarter after the decline at the end of 2015 (Figure 1)¹. The volume of industrial production increased by 1.9% in the first quarter of this year from the performance of the previous quarter (Figure 3). If analysed by NCA sections, economic activity grew in manufacturing, electricity, gas, steam and air conditioning supply, but fell in mining and quarrying. A high positive contribution to the growth in manufacturing came from the manufacture of electrical equipment, followed by the manufacture of fabricated metal products, except machinery and equipment, and food products. In terms of the main industrial groupings, the manufacture of intermediate goods and non-durables recorded a relatively high increase, while the manufacture of capital goods and durable consumer goods declined. At the same time, real retail trade turnover increased by 0.5% in January and February 2016 from the last quarter of 2015 (Figure 7). Positive developments were also recorded in construction, which was attributed to the increase in the volume of construction works in January and February. Construction works on buildings and civil engineering works increased, which primarily referred to infrastructure facilities.

The results of the survey on business expectations for April suggest an improvement in business optimism in construction and a slight decrease in industry, trade and service activities. With regard to consumer optimism, the Consumer Confidence Survey's results also point to a slight worsening in April, after a constant improvement recorded from the beginning of 2015. Such developments in the consumer confidence index were primarily the consequence of less favourable expectations of the financial situation in the household and poorer expectations regarding the overall economic situation in Croatia for the following period of one year. However, despite slightly less favourable expectations in April, business and consumer optimism indices were still at levels similar to those from the pre-crisis period (except construction, which was below that level).

The beginning of the current year was also marked by the continuation of favourable developments in the labour market. According to CPIA data, the increase in the number of employed persons intensified in the first three months of 2016 from the end of 2015, with a positive contribution from all activities, the largest individual contribution being made by trade.² In addition, the number of unemployed persons continued to decrease

in 2016. The number of unemployed persons declined rapidly on a quarterly basis due to an increase in the net outflow for employment and other business activities, as well as other reasons. In accordance with the above developments, the average registered unemployment rate declined and according to seasonally adjusted data in the first quarter of 2016 stood at 16% (relative to 16.6% at the end of 2015). The survey data also point to a decline in the unemployment rate (Figure 15). According to the latest available data for the first quarter of 2016, nominal gross and net wages showed a rise from the previous quarter, which was primarily generated by the private sector (Figure 16).

In March, the consumer price index increased by 0.7% from the previous month (Table 1), mostly because of the seasonal increase in the prices of clothing and footwear. In addition, the price of refined petroleum products increased due to the rise in crude oil prices in the world market (Figure 19), and the prices of fruit also increased slightly. On the other hand, the reduced prices of certain food products, primarily of milk, meat and oils, were partially mitigated by the monthly growth of consumer prices. The annual decline in consumer prices accelerated from -1.4% in February to -1.7% in March, which was mostly due to the movement in the prices of energy on an annual level (Figure 18). Despite the growth in the refined petroleum product prices in March, the negative contribution of energy prices to the annual inflation rate increased from -1.3 percentage points (from -0.8 percentage points in February) because of the base effect, i. e. a rather sharp increase in the prices of refined petroleum products in the same month of the previous year. In addition, the annual decline in the prices of certain food products accelerated, primarily of meat and milk, as a result of which the negative contribution of food prices increased from -0.5 percentage points in February to -0.6 percentage points in March. Conversely, the seasonal growth of clothing and footwear prices (sharper than in 2015) mitigated the unfavourable developments, so that the contribution of industrial products (excluding food and energy) to annual inflation was positive again, standing at 0.2 percentage points. The annual decline in the core inflation rate (which, among other things, excludes energy prices) slowed down in March to -0.5% , from -0.7% in February, largely as a result of the above mentioned movement in the prices of clothing and footwear (Figure 17).

Foreign trade in the first two months of 2016 was marked by the continuation of growth in imports and the decline in exports. The decrease in the total exports of goods in January and February relative to the average of the previous quarter (2.5%) was due to the decline in the exports of oil and refined petroleum products, as well as ships (Figure 10). If these two categories are excluded, the exports of the narrow aggregate continued to grow (7.4%), with the strengthening of the exports of capital goods and food, as well as of road vehicles and medical

1 For details, see Kunovac, D., and B. Špalat: *Nowcasting GDP Using Available Monthly Indicators* (W-39, October 2014).

2 According to the CBS data collected from the Report on income, income tax and surtax as well as contributions for mandatory insurances (JOPPD form), the number of employed persons in the first three months of 2016 decreased on a quarterly basis. However, these data should be interpreted with caution because of the short time series.

and pharmaceutical products, being particularly pronounced. Total goods imports grew by 3.1% in the first two months of the current year relative to the average of the last quarter of 2015 (Figure 11). The increase was distributed over a large number of SITC divisions, while the imports of crude oil and refined petroleum products decreased significantly. The increase in imports of the narrow aggregate (excluding ships and oil) was even sharper (7.4%). The growth in the imports of capital equipment, food products, manufactured goods classified chiefly by material, chemical products and miscellaneous manufactured articles was particularly noticeable.

The appreciation of the domestic currency continued during April, so that the exchange rate of the kuna against the euro at the end of the month was 0.6% lower from the end of March and 2.1% lower relative to the end of 2015, standing at EUR/HRK 7.48. Mild pressures in the direction of the appreciation of the kuna are usual in the period when there is a trend for there to be a surplus in the current account, largely brought about by the increase in the inflow of foreign currency because of the start of the tourist season. In addition, the appreciation of the exchange rate of the kuna was also partially produced by the anticipation of stronger foreign exchange inflows from EU funds and the announced new issue of government bonds abroad (in the year when foreign bonds do not mature), as well as the approaching of the closure of the cycle of deleveraging by credit institutions in the second quarter. In April, the kuna slightly appreciated against most other currencies in the basket of currencies for the calculation of the effective exchange rate, in addition to the euro, so that at the end of April the index of the nominal effective kuna exchange rate was 0.6% lower than at the end of March. The exchange rate of the kuna appreciated mostly against the zloty, yuan renminbi and US dollar, primarily because of the strengthening of the euro against these currencies in the global foreign exchange market.

The continued expansionary policy of the ECB and high banking sector liquidity in the euro area during April 2016 spurred a further fall in euro benchmark interest rates. The six-month EURIBOR stood at -0.14% at the end of April, while the overnight interest rate EONIA stood at -0.34% (Figure 24). Global risk aversion decreased slightly in the period under review, as did the average financing costs for parent banks of the largest domestic banks (Figure 26). Risk premiums for most European emerging market economies stagnated or also decreased (Figure 25). The risk premium for Croatia recorded the largest fall, by 13 b. p., but with the level of 257 b. p. it still remained much higher than in Central and Eastern European peer countries.

Abundant domestic financial system liquidity during April 2016 was supported by the CNB's monetary measures. The trend of reduced activity of credit institutions in the money market, which was reflected in a very small trading volume, continued. The weighted interest rate on overnight interbank loans in direct interbank trading stood at 0.30% in April 2016 (Figure 27). In April 2016, one auction of T-bills was held at which one-year kuna T-bills were placed, again at a historically low interest rate of 0.97% (Figure 30).

The gradual downward trend in the lending and deposit interest rates of banks continued in March 2016 (Figures 29, 30 and 31). The overall interest rate spread on balances continued

to rise slightly and stood at 4.86 percentage points at the end of March (Figure 32).

Monetary developments in March 2016, as well as in the whole of the first quarter, were marked by a noticeable decrease in the net foreign assets (NFA) of the monetary system, exceeding the increase in net domestic assets (NDA), which led to a fall in total liquid assets (M4). The fall in NFA was the consequence of the decrease in the net foreign assets of the CNB because of the outflow of government's foreign currency deposit with the central bank. The decrease in total liquid assets (M4) was mostly due to the decline in demand deposits and foreign currency deposits, however, the growth of this most widespread monetary aggregate accelerated on an annual level, standing at 5.2% at the end of March (Figure 41).

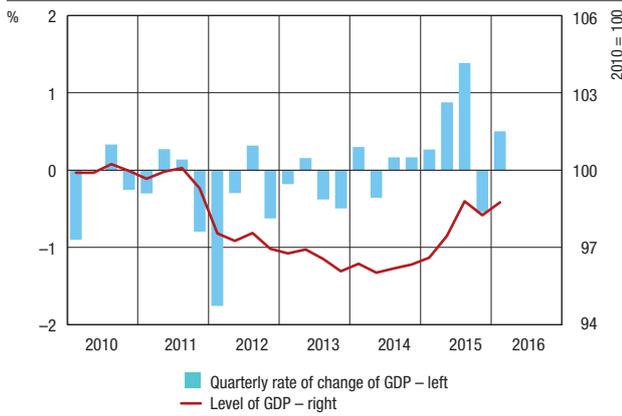
The placements of credit institutions to domestic sectors (not including the government) increased by 0.6% (transaction-based) in March, while the increase in the whole of the first quarter stood at 1.0% (Figure 35). The largest growth in March was recorded in placements to pension funds. Placements to non-financial corporations (Figure 36) also continued to grow moderately and lending to households also increased (Figure 37). With regard to the process of conversion and the partial write-off of household loans indexed to the Swiss franc, from the end of November 2015 until the end of March 2016, banks wrote off a total of HRK 5.4bn of loans. At the same time, the balance of total claims of credit institutions from households indexed to the Swiss franc dropped to HRK 3.4bn from HRK 21.7bn before the conversion.

Gross international reserves stood at EUR 13.2bn at the end of April, or down by 3.7% from the end of 2015 (Figure 47). The reduction in reserves during the first four months of 2016 was the consequence of the suspension of the reserve requirement allocation in a special account with the CNB, the lower level of the government's foreign currency deposit at the CNB and the strengthening of the euro against the US dollar. At the end of April, net usable reserves reached the level of EUR 11.0bn, or were 1.1% down from the end of the previous year.

The net external debt of domestic sectors increased slightly during the first two months of 2016 (Figure 51). The foreign assets of domestic sectors shrank by EUR 1.0bn, while their liabilities to foreign creditors fell by a somewhat lower amount (Figure 52). Changes with tendencies for the net foreign position to worsen materialised at the central bank and credit institutions, while other sectors decreased their net debt.

The preliminary cash data on the consolidated central government for January and the data on the performance of the government budget for January and February 2016 point to the continuation of favourable fiscal trends at the beginning of the year (Table 4). A relatively high rise in indirect taxes continued, and revenues from social contributions also increased. With regard to expenditures, the beginning of the year was apparently marked by a slight fall, probably attributable to the temporary financing that was in force at the time. In accordance with such movements the consolidated central government deficit decreased further on an annual level in January. The general government debt stood at HRK 291.1bn at the end of January 2016, having increased by HRK 1.5bn from the previous month. A half of the above mentioned increase in the general government debt refers to exchange rate differences.

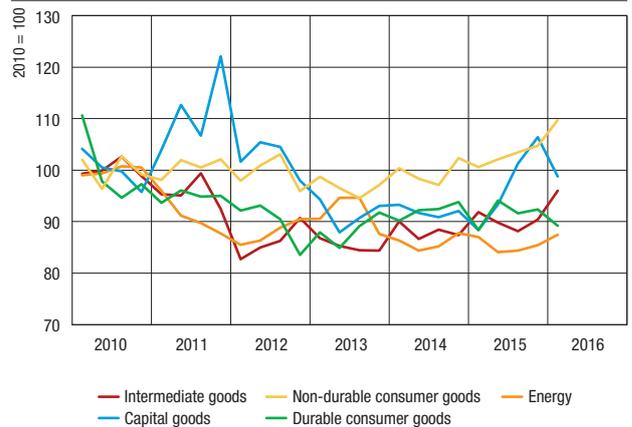
Figure 1 Quarterly gross domestic product seasonally and calendar adjusted real values



Note: Data for the first quarter of 2016 is the estimate derived using the CNB's Monthly indicator of real economic activity, on the basis of data published until 29 April 2016.

Sources: CBS data seasonally adjusted by the CNB and CNB calculations.

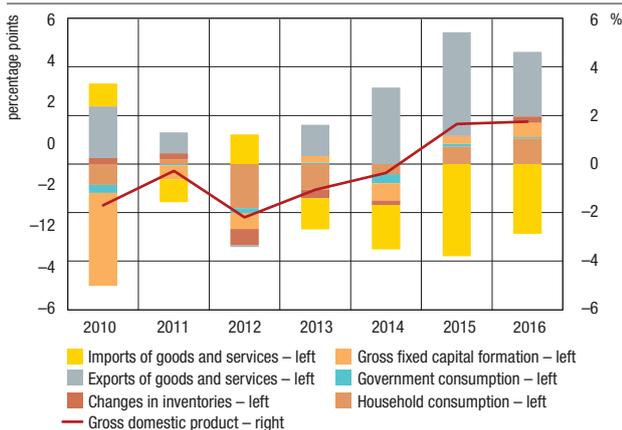
Figure 4 Industrial production by main industrial groupings seasonally adjusted indices



Note: Quarterly data are calculated as the average of monthly data.

Source: CBS data seasonally adjusted by the CNB.

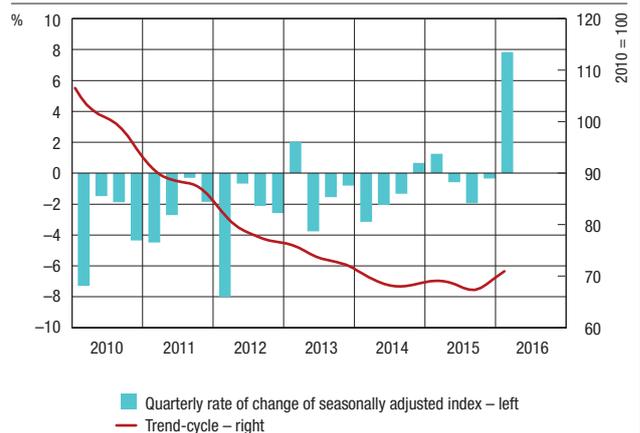
Figure 2 GDP rate of change contribution by components



Note: The projection for 2016 refers to the official projection of the CNB from March 2016.

Source: CBS.

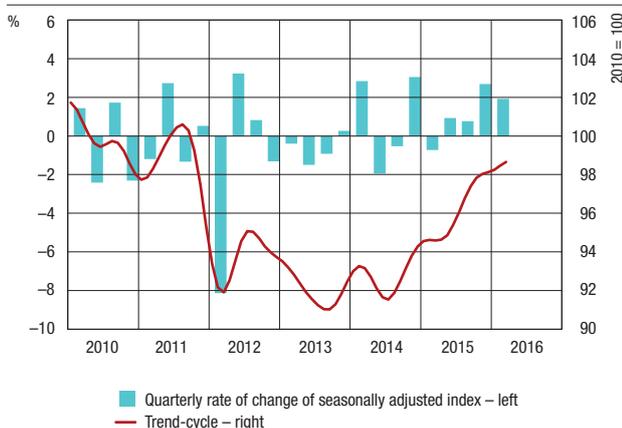
Figure 5 Total volume of construction works



Note: Data for the first quarter of 2016 refers to January and February.

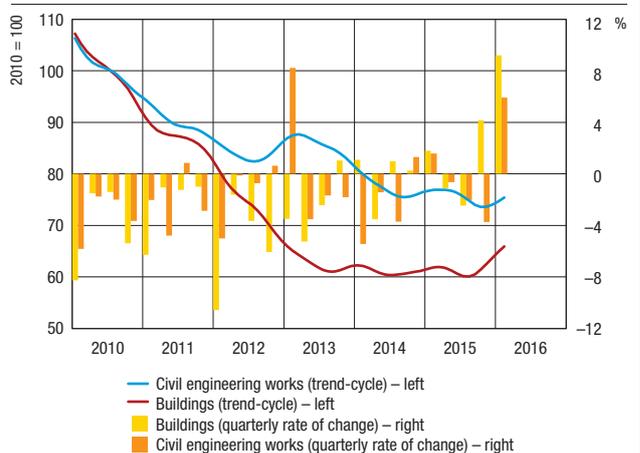
Source: CBS data seasonally adjusted by the CNB.

Figure 3 Industrial production



Source: CBS data seasonally adjusted by the CNB.

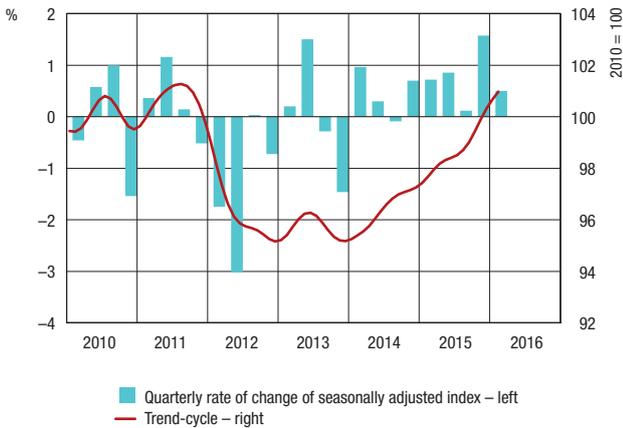
Figure 6 Buildings and civil engineering works



Note: Data for the first quarter of 2016 refers to January and February.

Source: CBS data seasonally adjusted by the CNB.

Figure 7 Real retail trade turnover



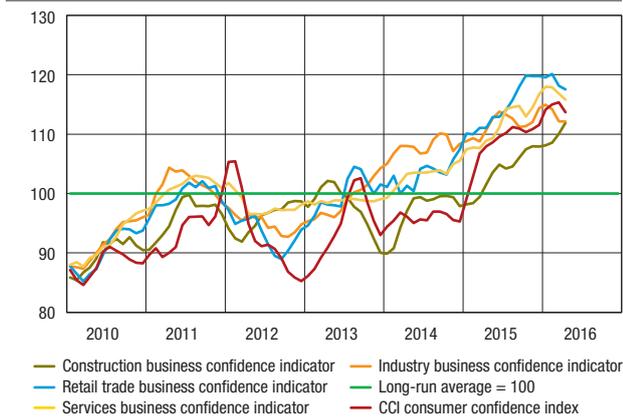
Note: Data for the first quarter of 2016 refers to January and February.
Source: CBS data seasonally adjusted by the CNB.

Figure 10 Goods exports (f.o.b.)



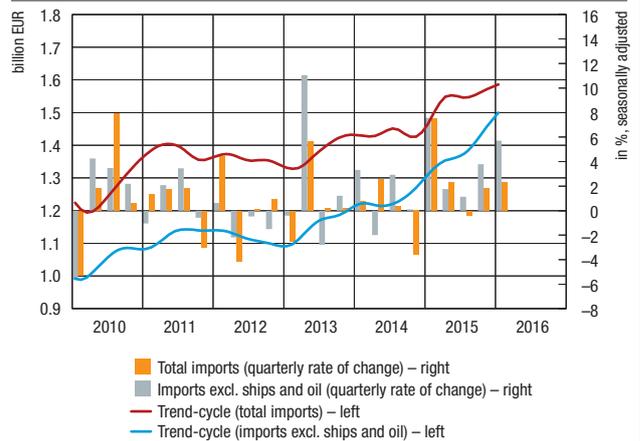
Note: Data for the first quarter of 2016 refer to January.
Source: CBS data seasonally adjusted by the CNB.

Figure 8 Business confidence indicators standardised and seasonally adjusted values, three-member moving averages



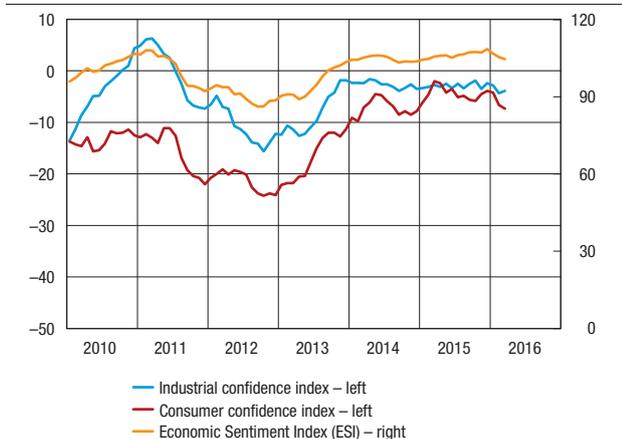
Note: New weights have been applied to the series of business confidence indicators; as of July 2014, the weights are based on total income instead of the number of employees. The Business Confidence Survey has been carried out since May 2008.
Sources: Ipsos, EC data seasonally adjusted and CNB.

Figure 11 Goods imports (c.i.f.)



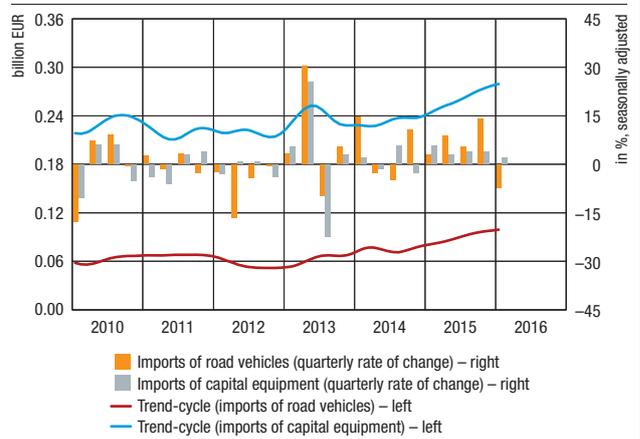
Note: Data for the first quarter of 2016 refer to January.
Source: CBS data seasonally adjusted by the CNB.

Figure 9 EU confidence indices seasonally adjusted indices



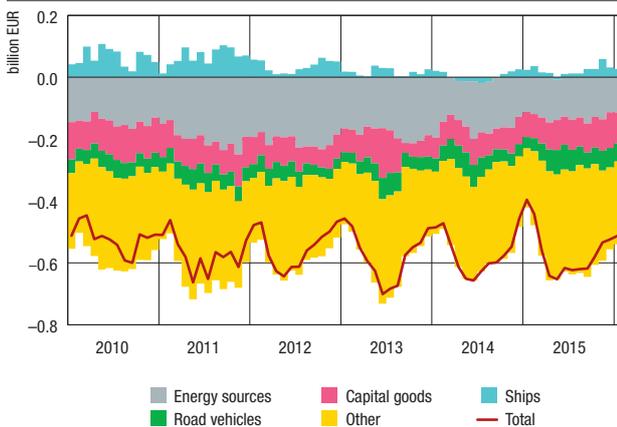
Source: Eurostat.

Figure 12 Imports of capital equipment^a and road vehicles (c.i.f.)



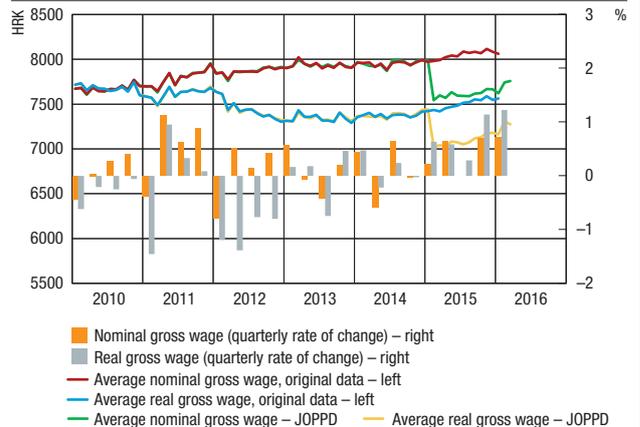
^a Imports of machinery (SITC divisions 71 – 77).
Note: Data for the first quarter of 2016 refer to January.
Source: CBS data seasonally adjusted by the CNB.

Figure 13 Trade in goods balance
three-member moving averages of monthly data



Source: CBS.

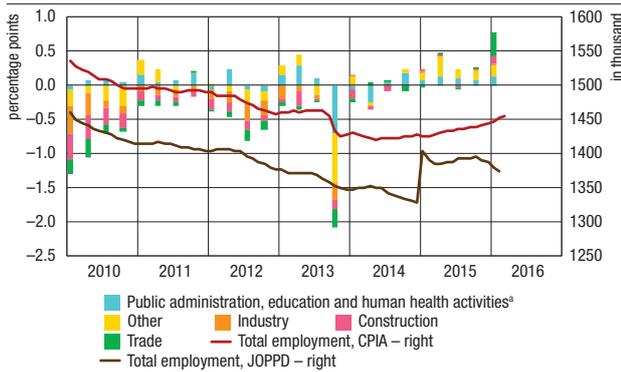
Figure 16 Average gross wages



^a From the second quarter of 2015, rates of change are based on the data contained in JOPPP form.

Source: CBS data seasonally adjusted by the CNB.

Figure 14 Total employment and contribution to employment growth by sector
seasonally adjusted series

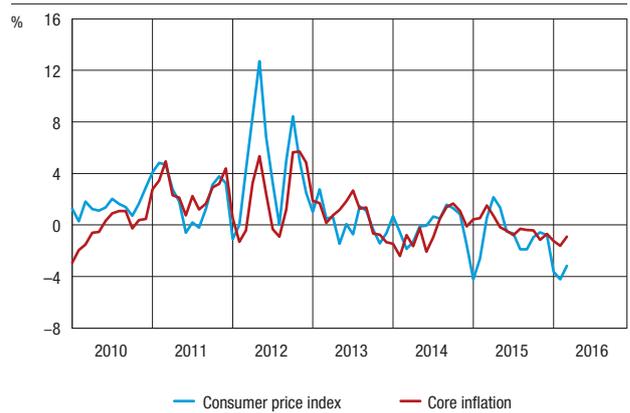


^a Public administration and defence; compulsory social security, education, human health and social work activities.

Note: Around 20,000 insured persons were removed from the CPIA register due to administrative reasons in October 2013. Structural columns show contributions by sector in accordance with CPIA data.

Source: CPIA and CBS data seasonally adjusted by the CNB.

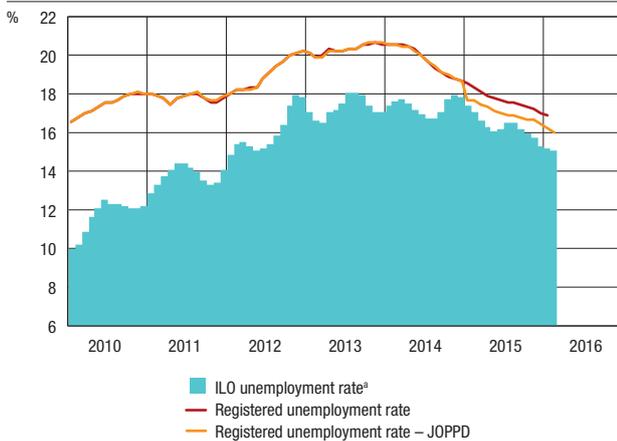
Figure 17 Consumer price index and core inflation
annualised month-on-month rate of change^a



^a The month-on-month rate of change is calculated based on the quarterly moving average of seasonally adjusted consumer price indices.

Sources: CBS and CNB calculations.

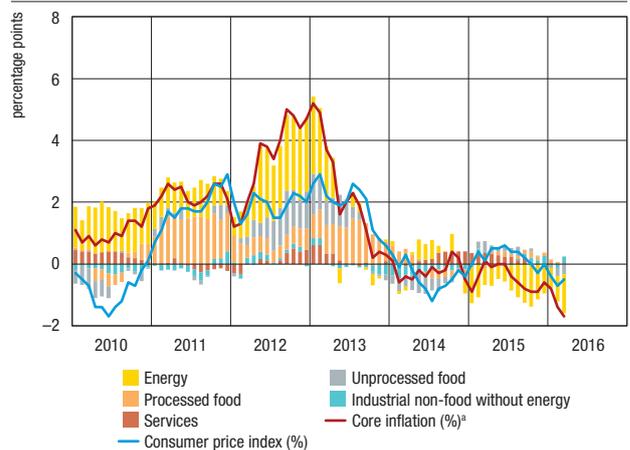
Figure 15 Registered and ILO unemployment rates
seasonally adjusted data



^a Monthly ILO unemployment rate is Eurostat's estimate.

Sources: CES and Eurostat data seasonally adjusted by the CNB.

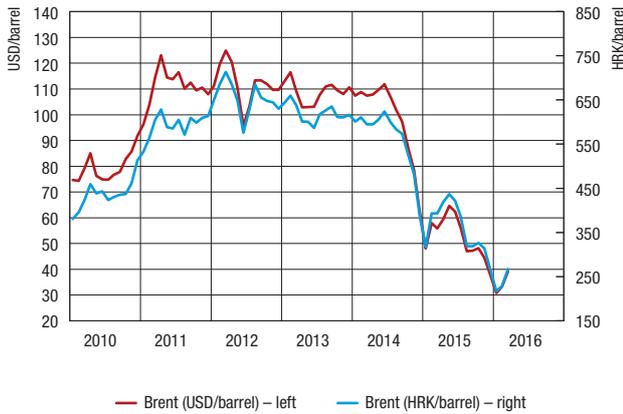
Figure 18 Year-on-year inflation rates and components' contribution to consumer inflation



^a Core inflation does not include agricultural product prices and administrative prices.

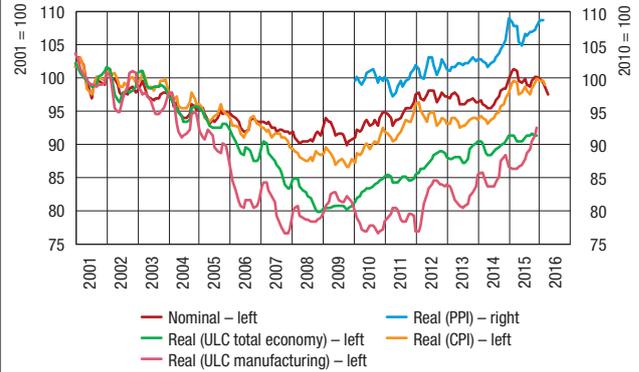
Sources: CBS and CNB calculations.

Figure 19 Crude oil prices (Brent)



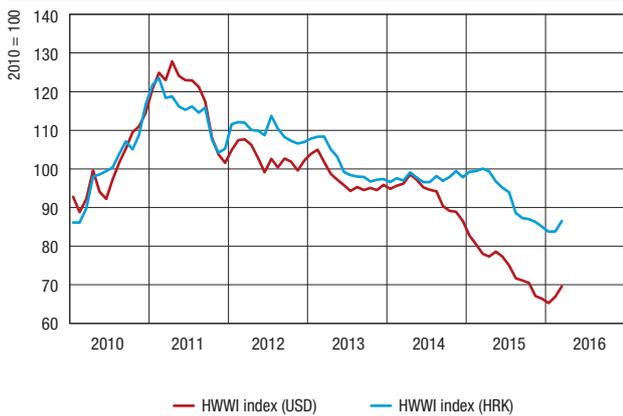
Sources: Bloomberg and CNB calculations.

Figure 22 Nominal and real effective exchange rates of the kuna



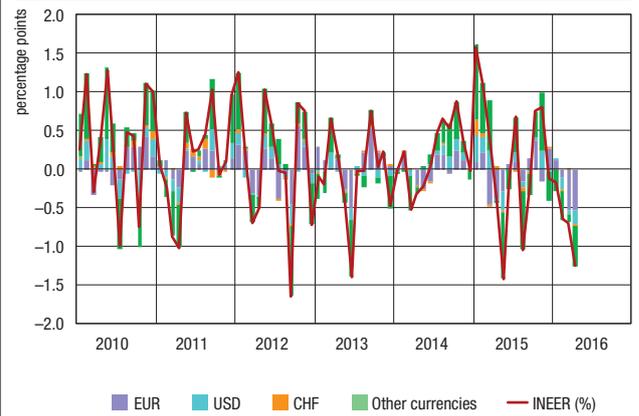
Note: Real effective exchange rate of the kuna deflated by producer prices includes the Croatian index of industrial producer prices on the non-domestic market, which is available from January 2010. Real effective exchange rate of the kuna deflated by unit labour costs is the result of the interpolation of quarterly values. A fall in the index denotes an effective appreciation of the kuna.
Source: CNB.

Figure 20 HWWI index (excl. energy)



Sources: HWWI and CNB calculations.

Figure 23 Contributions^a of individual currencies to the monthly rate of change of the average index of the nominal effective kuna exchange rate (INEER)



^a Negative values denote contributions to the appreciation of the INEER.
Source: CNB.

Figure 21 Daily nominal exchange rate – HRK vs. EUR, USD and CHF
CNB midpoint exchange rate



Source: CNB.

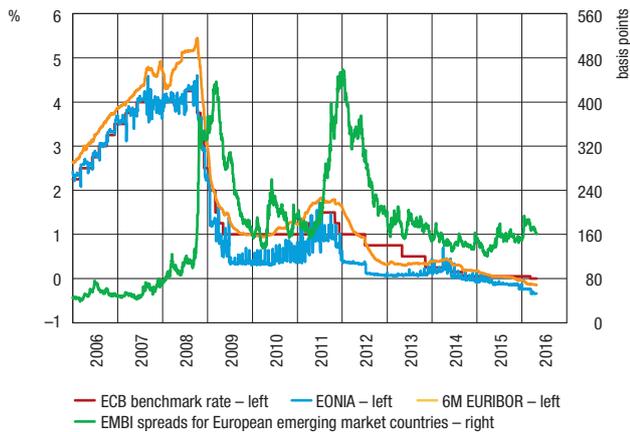
Table 1 Price indicators

year-on-year and month-on-month rates of change

	Year-on-year rates		Month-on-month rates	
	2/2016	3/2016	3/2015	3/2016
Consumer price index and its components				
Total index	-1.4	-1.7	1.0	0.7
Energy	-4.9	-7.4	3.4	0.6
Unprocessed food	-2.9	-3.4	0.0	-0.5
Processed food (incl. alcoholic drinks and tobacco)	0.3	-0.1	-0.4	-0.7
Industrial non-food without energy	-0.5	0.9	2.0	3.4
Services	0.0	0.1	-0.2	-0.1
Other price indicators				
Core inflation	-0.7	-0.5	0.6	0.8
Index of industrial producer prices on the domestic market	-4.8	-5.0	1.2	1.1
Brent crude oil price (USD)	-42.7	-30.0	-3.7	17.7
HWWI index (excl. energy) ^a	-16.9	-10.8	-3.1	4.0

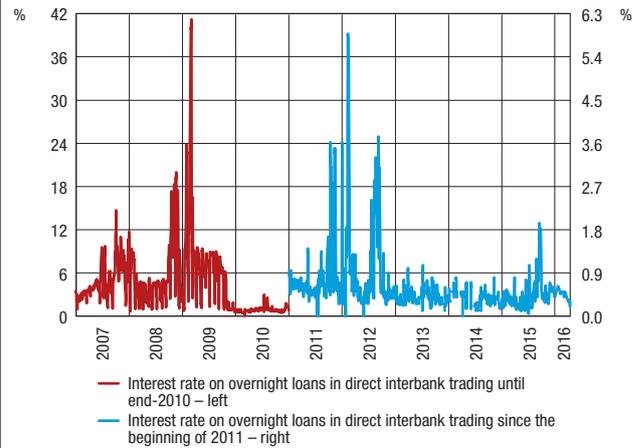
^a The index is calculated on the basis of raw materials prices expressed in US dollars.
Sources: CBS, Bloomberg, HWWI and Eurostat.

Figure 24 Interest rates on the euro and the average yield spread on bonds of European emerging market countries



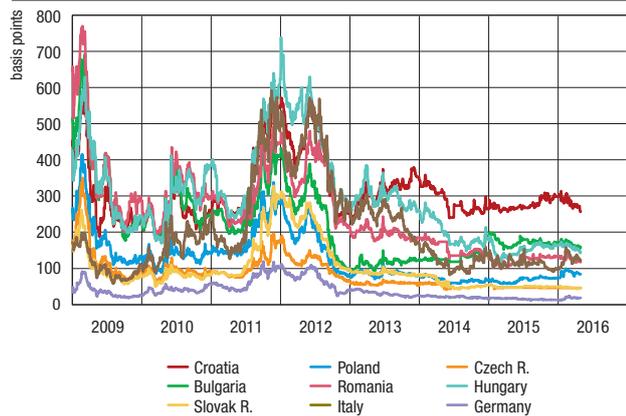
Sources: ECB, Bloomberg and J. P. Morgan.

Figure 27 Average interest rate on the money market daily data, on annual basis



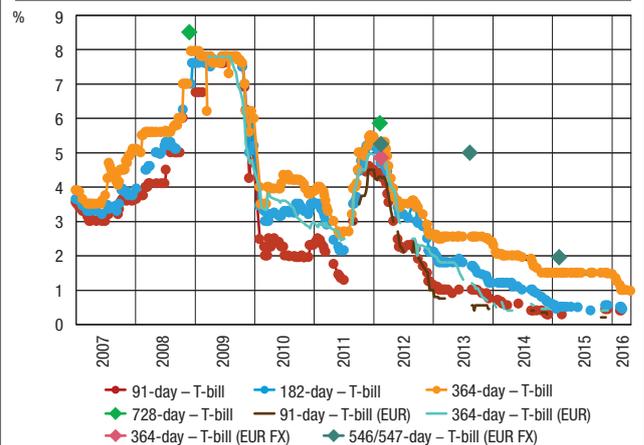
Source: CNB.

Figure 25 CDS spreads for 5-year government bonds of selected countries



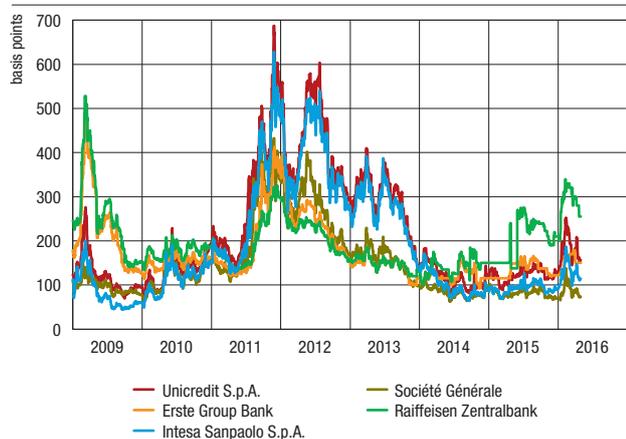
Note: Credit default swaps (CDS) spread is an annual premium that a CDS buyer pays for protection against credit risk associated with an issuer of an instrument.
Source: Bloomberg.

Figure 28 Interest rates on kuna and euro T-bills on auction days



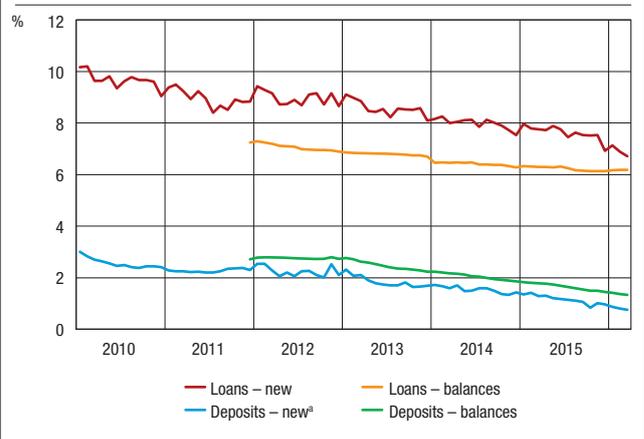
Source: CNB.

Figure 26 CDS spreads for selected parent banks of domestic banks



Source: Bloomberg.

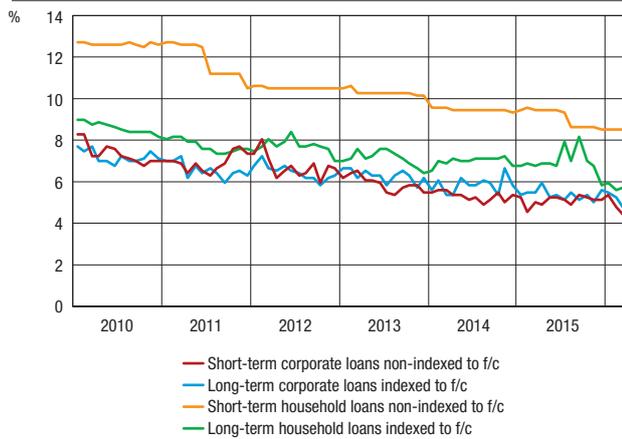
Figure 29 Average interest rates on loans (excl. revolving loans) and deposits on annual basis



^a For time deposits, interest rates on newly received deposits are weighted by their balances.

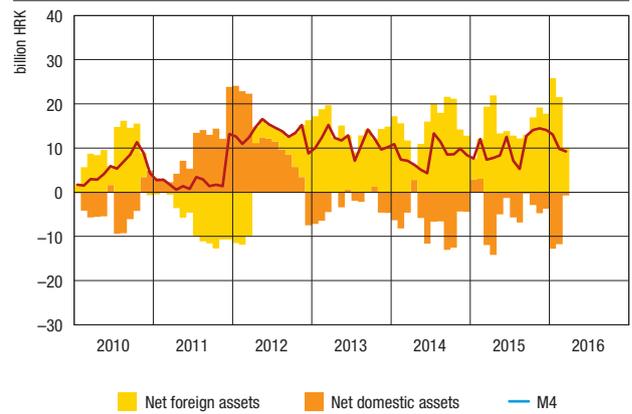
Source: CNB.

Figure 30 Average interest rates on new kuna loans (excl. revolving loans) on annual basis



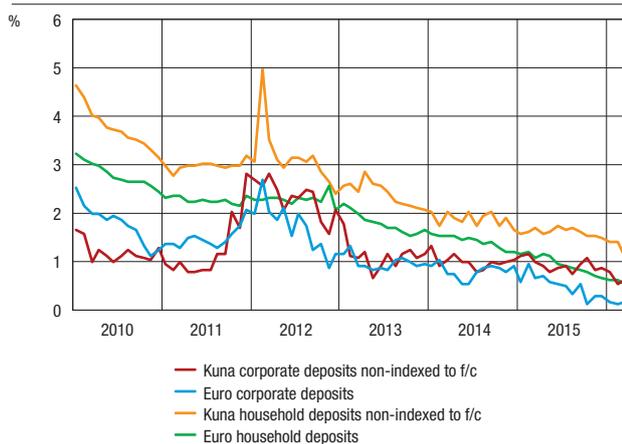
Source: CNB.

Figure 33 Net foreign assets, net domestic assets and total liquid assets (M4) absolute change in the last 12 months



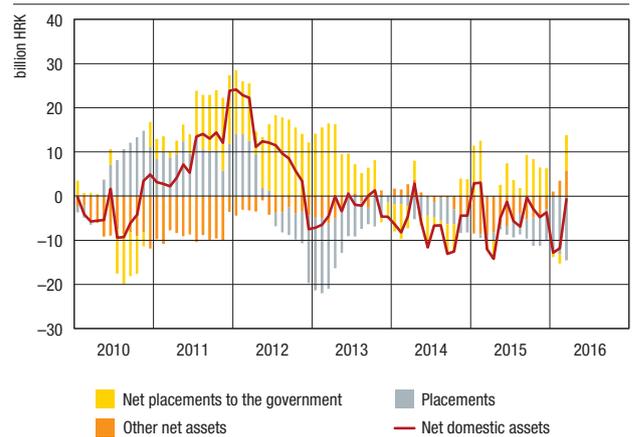
Source: CNB.

Figure 31 Average interest rates on new time deposits maturing in three months on annual basis



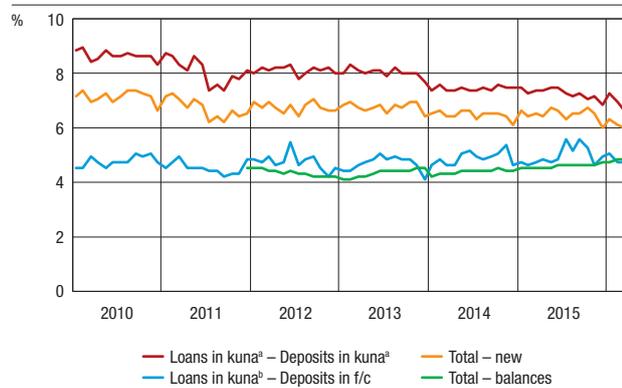
Source: CNB.

Figure 34 Net domestic assets, structure absolute change in the last 12 months



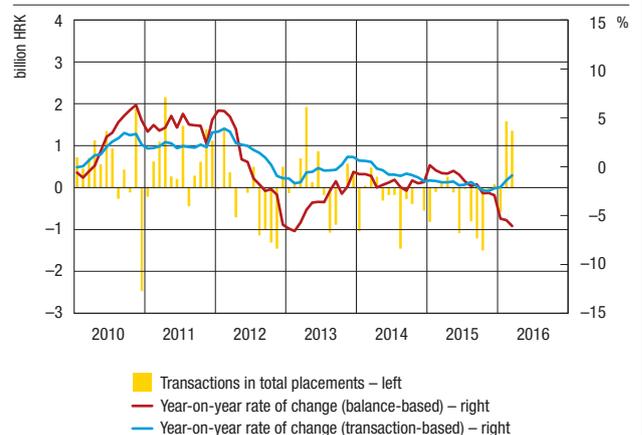
Source: CNB.

Figure 32 Spread between interest rates on loans (excl. revolving loans) and interest rates on deposits on annual basis



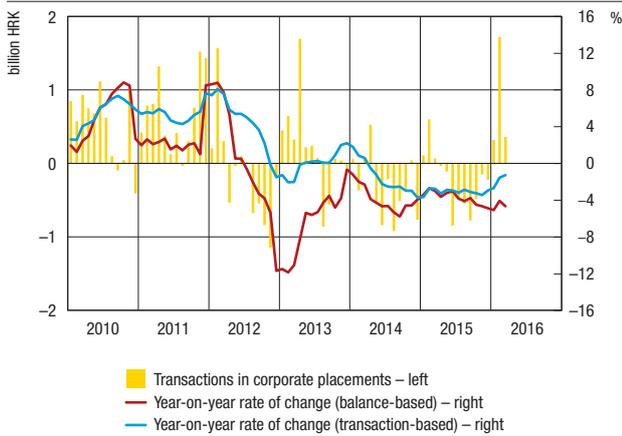
^a Non-indexed to f/c. ^b Indexed to f/c.
 Note: Spread between average interest rates on loans and average interest rates on deposits should be differentiated from net interest margin (the ratio of the difference between interest income and interest expenses to total assets of credit institutions).
 Source: CNB.

Figure 35 Placements



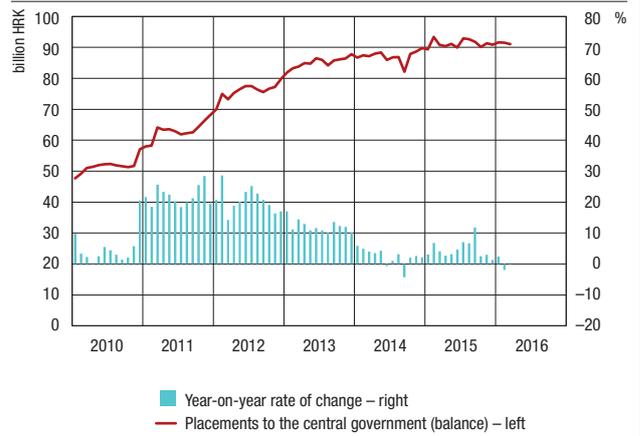
Source: CNB.

Figure 36 Placements to corporates



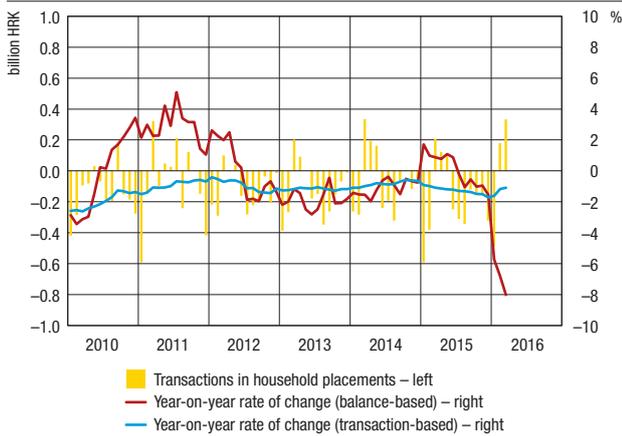
Source: CNB.

Figure 39 Credit institution and MMF placements to the central government



Source: CNB.

Figure 37 Placements to households



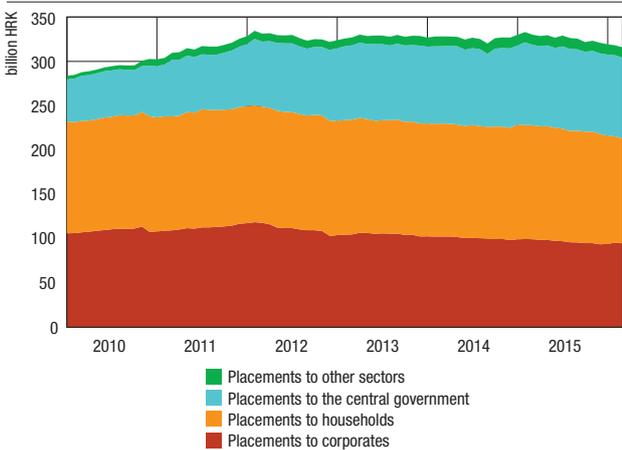
Source: CNB.

Figure 40 Money (M1)



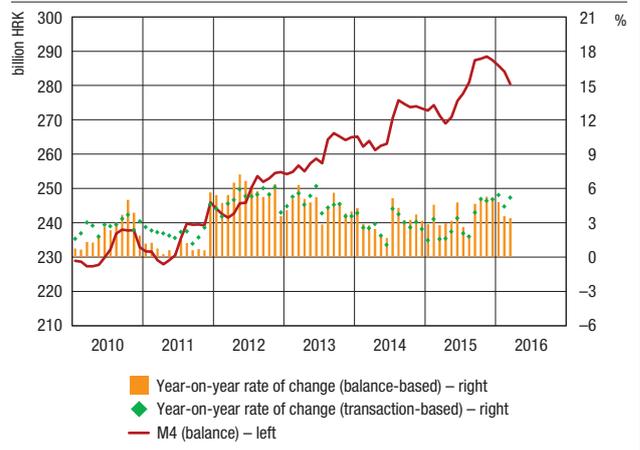
Source: CNB.

Figure 38 Structure of credit institution placements



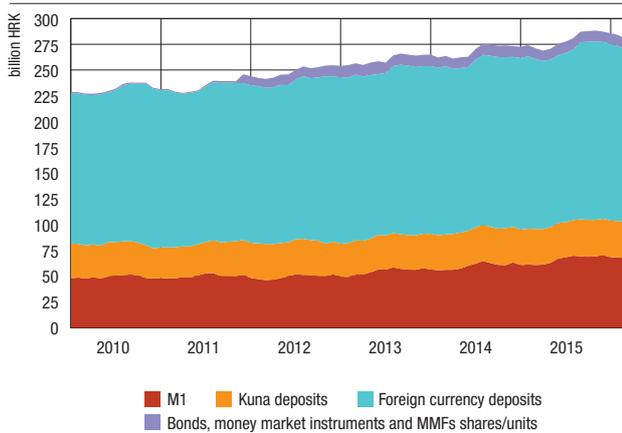
Source: CNB.

Figure 41 Total liquid assets (M4)



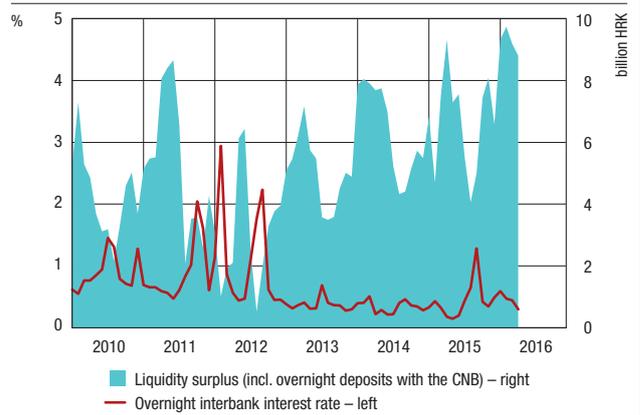
Source: CNB.

Figure 42 Structure of M4 monetary aggregate



Source: CNB.

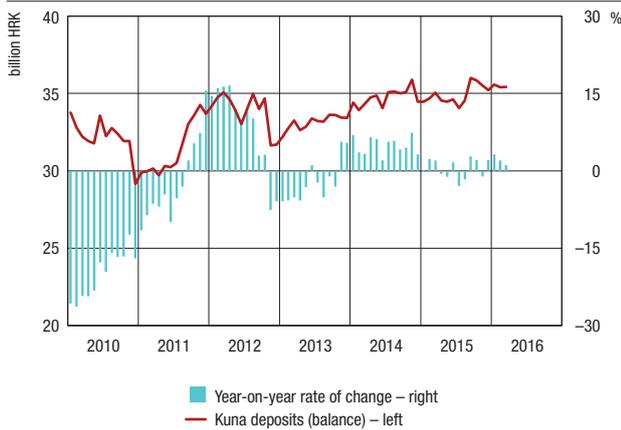
Figure 45 Bank liquidity and overnight interbank interest rate



Note: Liquidity surplus is the difference between the balance in bank settlement accounts with the CNB and the amount that banks are required to hold in their accounts after the calculation of reserve requirements.

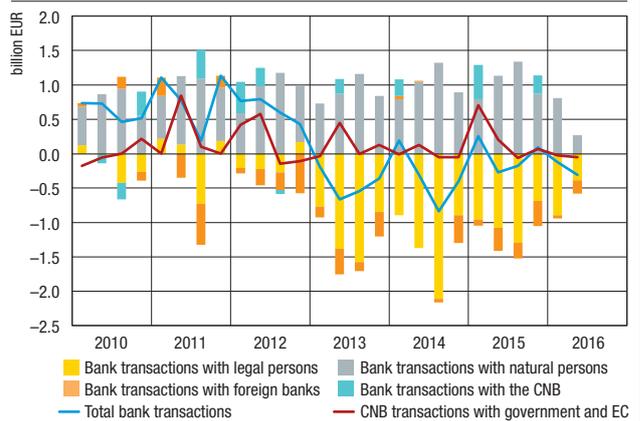
Source: CNB.

Figure 43 Kuna savings and time deposits



Source: CNB.

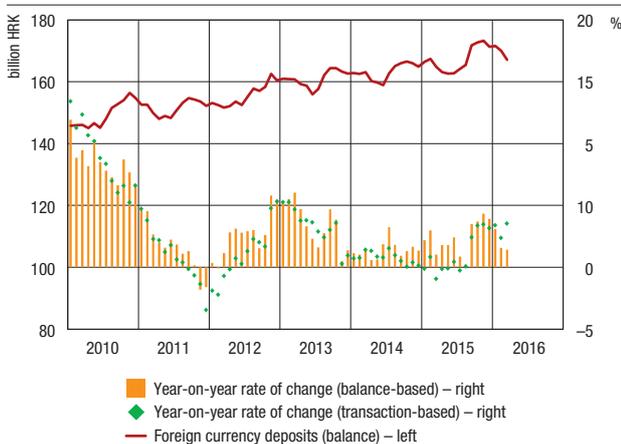
Figure 46 Spot transactions in the foreign exchange market (net turnover)



Note: Positive values denote net purchases and negative values denote net sales. Legal persons include the government. Data for the second quarter of 2016 refer to April.

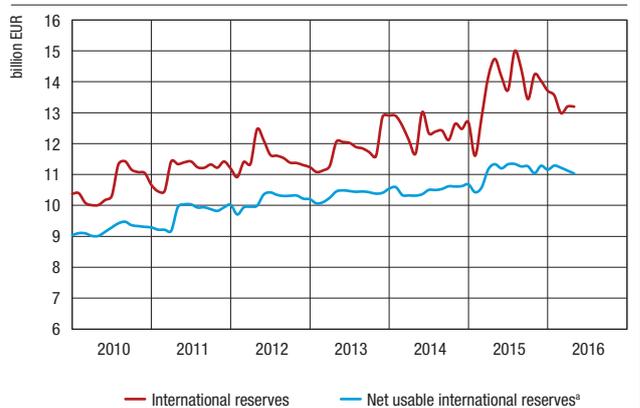
Source: CNB.

Figure 44 Foreign currency deposits



Source: CNB.

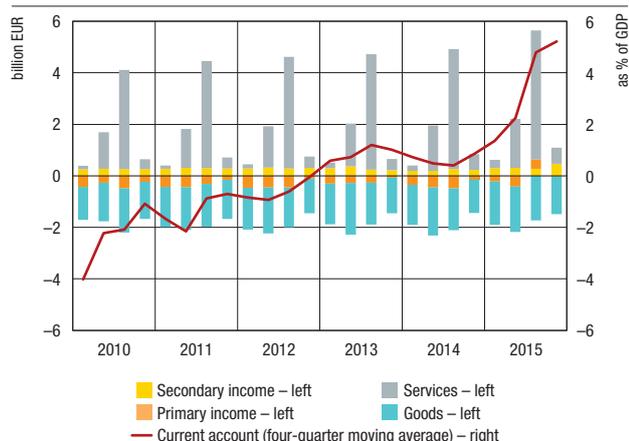
Figure 47 International reserves of the CNB at current rate of exchange



^a NUIR = international reserves – foreign liabilities – reserve requirements in f/c – foreign currency government deposits.

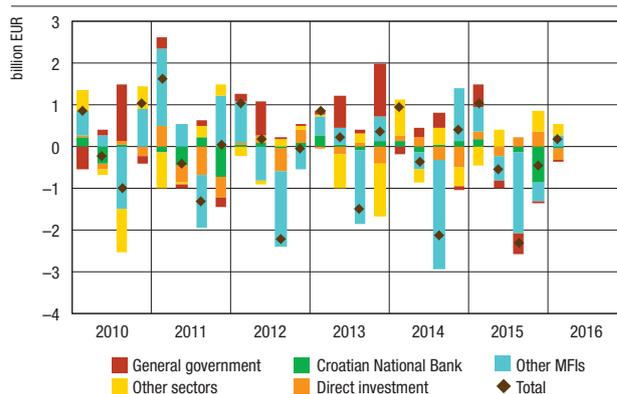
Source: CNB.

Figure 48 Current account flows



Source: CNB.

Figure 51 Net external debt (NED) transactions^a

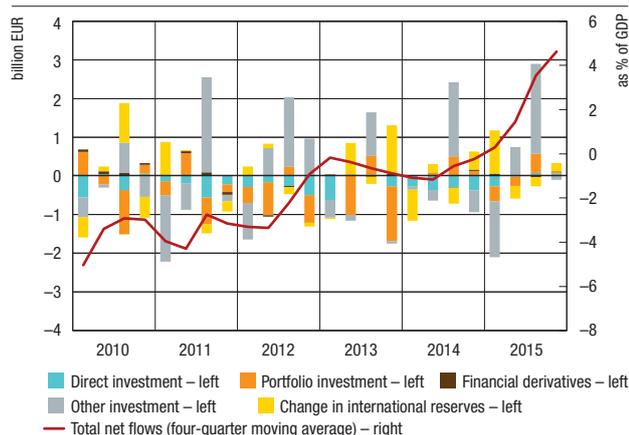


^a Transactions refer to the change in debt excl. cross-currency changes and other adjustments. Net external debt is calculated as gross external debt stock net of foreign debt claims.

Note: Data for the first quarter of 2016 refer to January and February.

Source: CNB.

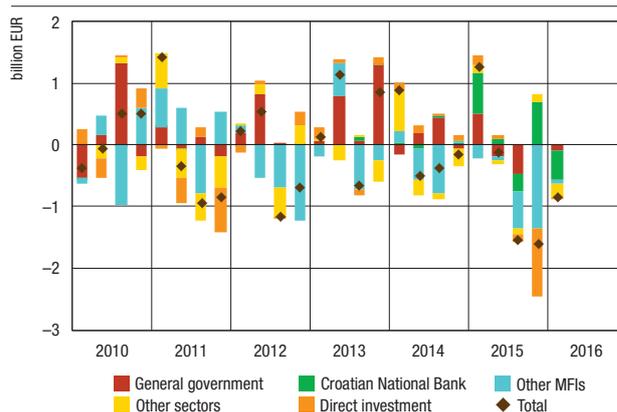
Figure 49 Financial account flows



Note: A positive value denotes net outflow of equity abroad (including on the basis of the growth in international reserves).

Source: CNB.

Figure 52 Gross external debt (GED) transactions^a

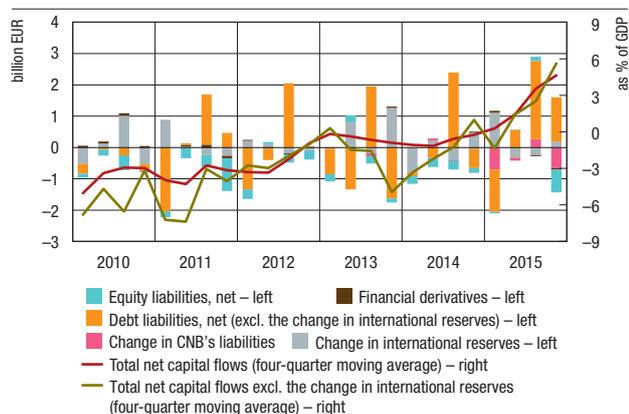


^a Transactions refer to the change in debt excl. cross-currency changes and other adjustments.

Note: Data for the first quarter of 2016 refer to January and February.

Source: CNB.

Figure 50 Financial account flows by type of investment



Note: A positive value denotes net outflow of equity abroad (including on the basis of the growth in international reserves). Net liabilities represent the difference between the change in assets and the change in liabilities.

Source: CNB.

Table 2 Balance of payments^a

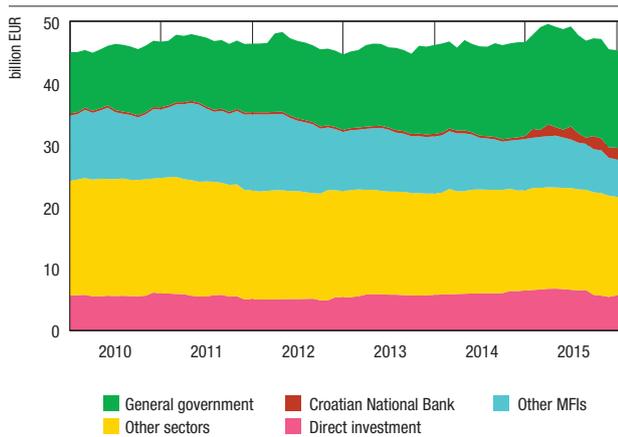
preliminary data, in million EUR

	2014	2015	Indices	
			2014 / 2013	2015 / 2014
Current account	368.3	2,293.4	83.1	622.7
Capital account	85.4	174.5	142.4	204.3
Financial account (excl. reserves)	426.7	1,287.5	–	301.7
International reserves	–529.9	745.3	–	–
Net errors and omissions	–556.9	–435.1	62.6	78.1

^a In line with the 6th edition of the Balance of Payments and International Investment Position Manual (BPM6).

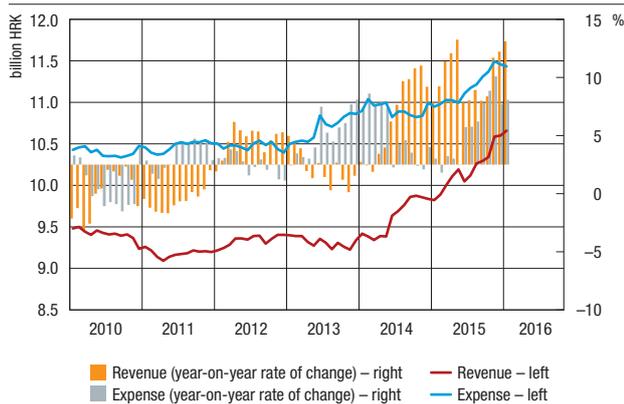
Source: CNB.

Figure 53 Gross external debt
end of period



Source: CNB.

Figure 54 Consolidated central government revenue and expense^a
GFS 2001



^a Trend-values are calculated as 12-month moving averages of original data. Expense includes expenditures for the acquisition of non-financial assets. From January 2008 on, CM is excluded from consolidated central government.

Sources: MoF and CNB calculations.

Table 3 Consolidated general government balance

ESA 2010, in million HRK

	Jan. – Dec. 2014	Jan. – Dec. 2015
Total revenue	139,958	146,087
Direct taxes	20,089	19,768
Indirect taxes	61,439	65,338
Social contributions	38,671	39,778
Other	19,760	21,202
Total expenditure	158,037	156,793
Social benefits	54,388	54,800
Subsidies	6,423	5,629
Interest	11,464	11,925
Compensation of employees	38,701	38,147
Intermediate consumption	26,251	26,910
Investment	12,058	9,387
Other	8,753	9,996
Net lending (+) / borrowing (-)	-18,079	-10,706

Sources: Eurostat and CBS.

Table 4 Government budget deficit

ESA 2010, in million HRK

	Jan. 2015	Jan. 2016
1 Revenue	9,101	9,759
2 Disposal of non-financial assets	26	22
3 Expenditure	10,567	10,297
4 Acquisition of non-financial assets	147	171
5 Net borrowing (1 + 2 – 3 – 4)	-1,587	-687

Sources: MoF and CNB calculations.

Table 5 General government debt

in million HRK

	Jan. 2015	Jan. 2016
Change in total debt stock	-3,999	1,476
Change in domestic debt stock	-948	2,091
– Securities other than shares, short-term	-661	836
– Securities other than shares, long-term	-1,364	1,134
– Loans	1,081	120
Change in external debt stock	-3,051	-615
– Securities other than shares, short-term	-83	94
– Securities other than shares, long-term	-3,291	-828
– Loans	323	119
Memo item:		
Change in total guarantees issued	303	-974

Source: CNB.

